

BABERGH DISTRICT COUNCIL and MID SUFFOLK DISTRICT COUNCIL

From: Assistant Director Assets and Commercial Delivery	Report Number: S83
To: Council (Mid Suffolk) Council (Babergh)	Date of meeting: 21 November 2016 22 November 2016

ASSETS AND INVESTMENT STRATEGY

1. Purpose of Report

1.1 This report sets out two elements of an emerging approach to managing assets and investment. Firstly, the report seeks approval for an Assets and Investment Strategy made up of three strands;

- Strand 1 – Investment (Profit for Purpose)
- Strand 2 – Regeneration and Development
- Strand 3 – Asset Management

1.2 Secondly, and essential to the delivery of Strand 1 of the strategy, approval is being sought for a wholly owned incorporated structure for investment in commercial property for profit. If approved, a full business plan will then be placed before Council for consideration in spring 2017 before the company starts to trade.

1.3 For ease of reference, the Key Information part of this report is subdivided into four sections:

Section One	The three strands of the Assets and Investments Strategy
Section Two	The business case for a wholly owned incorporated structure for investment in commercial property. (Confidential)
Section Three	The recommended model for the wholly owned incorporated structure for investment in commercial property.
Section Four	The Implementation Plan for the wholly owned incorporated structure for investment in commercial property.

2. Recommendations

2.1 That Members approve the three strands of the Assets and Investment Strategy.

2.2 That Members approve an incorporated structure for investment in commercial property which will then be the subject of a business plan to be brought forward for approval in early 2017. The incorporated structure to be made up of;

- i. A Babergh/Mid Suffolk District Council Holding Company.
- ii. A Joint Capital Investment Fund Special Purpose Vehicle owned 50:50 with Babergh/Mid Suffolk District Council holding the fund for investment.

2.3 That Members approve the Capital Investment Fund model and structure as set out in the business case (as contained in Confidential Appendix 1 to Paper S83), legal, tax and company structure advice all appended to this report.

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3. Financial and Tax Implications

3.1 Capital Funding for the Asset and Investment Strategy

It is proposed that any project falling within the three strands will be delivered through funding from the following sources:

- Revenue e.g. Transformation Fund Reserves
- Borrowing e.g. Public Works Loan Board (PWLB)
- Capital Receipts

3.2 A set of investment parameters will be developed which will support funding and investment decisions from these sources. Each investment project proposal will be accompanied by a business case, which sets out the funding required, project viability and deliverability and expected return on investment, social returns and pay-back period where appropriate.

3.3 In time, and given the right market circumstances, private borrowing in the market place might also be appropriate and may even be prudent. There is no plan to take this approach in the short to medium term however the structures proposed in this report do allow for this possibility subject to a further business case and approvals.

3.4 Tax advice has been requested specifically for each option under consideration for the investment in commercial property. This advice can be found in in the Trowers and Hamlins LLP options paper and is attached as Appendix 2 to this report.

3.5 Revenue Funding for the Asset and Investment Strategy

3.6 A Transformation Fund budget has already been approved which provides revenue funding to support the reasonable costs of necessary feasibility work to support investment projects.

3.7 Funding for the Capital Investment Fund Special Purpose Vehicle (SPV)

3.8 The first initiative designed to deliver Strand One (Profit for Purpose) of the Assets and Investment Strategy, is the proposal for each Council to establish its own holding company and then jointly establish a subsidiary SPV with 50/50 share distribution. This SPV will then invest funds for a commercial return. To support this, both Councils will individually source £25m funding from the PWLB. This aggregated £50m in a single SPV helps the Councils benefit from increased scale, economies in overheads and administration costs and in the diversification of risk.

3.9 The £25m investment from each Council was approved as part of 2015/16 budget setting in February 2016. The Mid Suffolk report reference was C/03/15 (26th February 2015) and the Babergh report reference was P107 (24th February 2015). As part of that approval a full business case was required to be presented which included details of how strategic priority outcomes would be met and what returns on investment would be on offer.

3.10 Each Council will 'on-lend' its funding at a commercial interest rate to ensure that State Aid regulations are not breached. Funding will be drawn down by the Council's as and when the SPV identifies suitable assets to acquire. This will prevent unnecessary and costly unused financial facility being held until absolutely necessary.

3.11 Initial advice from Arlingclose Ltd, the Councils' retained treasury advisors, has advised that funding is currently available at historically low rates with property viewed as long term security (up to 50 years). Indicative rates at 09.09.2016 are detailed below:

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- Rolling Local Authority loans 0.28% to 1.29%
- Other Fixed rate loans 2.07% to 2.13%
- PWLB fixed annuity 2.15%

3.12 The Council's treasury advisor, Arlingclose Ltd, has provided a detailed financial model which is appended to the Business Case attached to this report

4. Legal Implications

4.1 The Council has appointed Trowers & Hamblins LLP, legal advisers, who have experience of advising local authorities on "profit for purpose" initiatives to supplement the Council's in-house adviser in specific specialist areas given the innovative nature of this initiative and its high value. Trowers & Hamblins LLP have confirmed that each Council has the legal powers to carry out and give effect to the recommendations as set out in this report and their detailed advice is attached as Appendix 2.

4.2 In preparing this report, regard has been had to the statutory Guidance on the Power in the Local Government Act 2003 and the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 which requires an authority to prepare a business case in support of the proposed exercise of the power to do for a commercial purpose anything which the Council is authorised to do for the purpose of carrying on any of its ordinary functions and the business case required is to be a comprehensive statement as to:

- (a) the objectives of the business,
- (b) the investment and other resources required to achieve those objectives,
- (c) any risks the business might face and how significant these risks are, and
- (d) the expected financial results of the business, together with any other relevant outcomes that the business is expected to achieve.

When exercising any power, the Council must act for a proper purpose and have regard to the usual "Wednesbury" reasonableness principles, its fiduciary duty to obtain value for money and whether the Council's involvement in the CIS would be proportionate and properly balanced against the anticipated benefits as well as the wider interests of the Council's local Business Rate and Council Tax payers. There is nothing in this report which indicates any cause for concern with regard to any of those matters.

5. Risk Management

5.1 This report is most closely linked with the following Corporate / Significant Business Risks:

Risk Description	Likelihood	Impact	Mitigation Measures
4a. Failure to invest in property to generate income and regenerate local areas	3	3	Develop new capital investment strategy; Consideration of commercial opportunities; Alternative investment of cash balances

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Risk Description	Likelihood	Impact	Mitigation Measures
5f. Failure of the Councils to become financially sustainable in response to funding changes	2	4	Continued development of the strands within the Medium Term Financial Strategy (MTFS) / Alignment of resources to priorities / Use of one-off funding to change the business model and support functions during change / Early identification of initiatives for the 2017/18 budget / Engagement of councillors to understand options / Modelling and analysis to understand impact

Source: Corporate Risk Register

5.2 A detailed risk register which sets out further risks specifically related to the Capital Investment Fund is attached to the business case appended to this report.

6. Consultations

6.1 Development of the Assets and Investment Strategy and Capital Investment Fund Strategy has included the following consultation:

- Joint Babergh / Mid-Suffolk Member Workshops
- Cross Party Member Task and Finish Group
- Officer consultations covering Finance, Legal and Risk

6.2 The Councils have commissioned advice from JLL (Property advice), Trowers and Hamlins LLP (Legal, Company Structure and Tax advice) and Arlingclose Ltd (Funding and Treasury advice) to support the development of proposals in this report.

6.3 The Councils Monitoring Officer has been consulted and has reviewed the information in this report which is relevant to their statutory role.

6.4 The Councils s151 Officer has been consulted and has reviewed the information in this report. The s151 Officer has led the work with Arlingclose to produce the financial model appended to this report in the Business case – Confidential Appendix 1.

7. Equality Analysis

An equality impact analysis has been completed for the project and this is attached as Appendix 3.

8. Shared Service / Partnership Implications

8.1 The Asset and Investment Strategy will operate jointly across both Babergh and Mid Suffolk councils and will seek to maximise opportunities for collaborative working between the Councils and other public and private sector partners to deliver; income, homes, jobs and social value for the councils districts.

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9. Links to Joint Strategic Plan

9.1 The Refreshed Joint Strategic Plan developed in 2016 establishes the framework for the Councils priorities: Economy and Environment; Housing and Strong and Healthy Communities. The strategic outcomes which can be effectively supported by the Asset and Investment Strategy include:

- Investment in land and property to generate income and regenerate areas
- Manage our corporate assets effectively
- Manage our housing assets effectively
- Making best use of land and buildings across the Suffolk System
- Financially sustainable Councils
- Community led solutions to deliver services and manage assets
- Existing estate regeneration

9.2 The Medium Term Financial Strategy 2016 – 2020 outlines the Councils ambitions to:

- Create an investment strategy that maximises incentivised and other funding streams e.g. New Homes Bonus and Business Rates and that delivers additional income and savings in the future e.g. doing things on an 'Invest to Save' or 'Profit for Purpose' basis

9.3 Links to both these documents can found at Paragraph 15 of this report.

10. Key Information

10.1 In response to the continued reduction and complete cessation of Central Government Rate Support Grant by 2020, Members have articulated their aim to become financially sustainable councils in both the Joint Strategic Plan and Medium Term Financial Strategy.

10.2 The Medium Term Financial Strategy specifically sets out the following objectives:

- An investment strategy that maximises incentivised and other funding streams e.g. New Homes Bonus and Business Rates and that delivers additional income and savings in the future e.g. doing things on an 'Invest to Save' or 'Profit for Purpose' basis
- A more commercial approach, which could include the establishment of a trading company through which we can generate additional income.

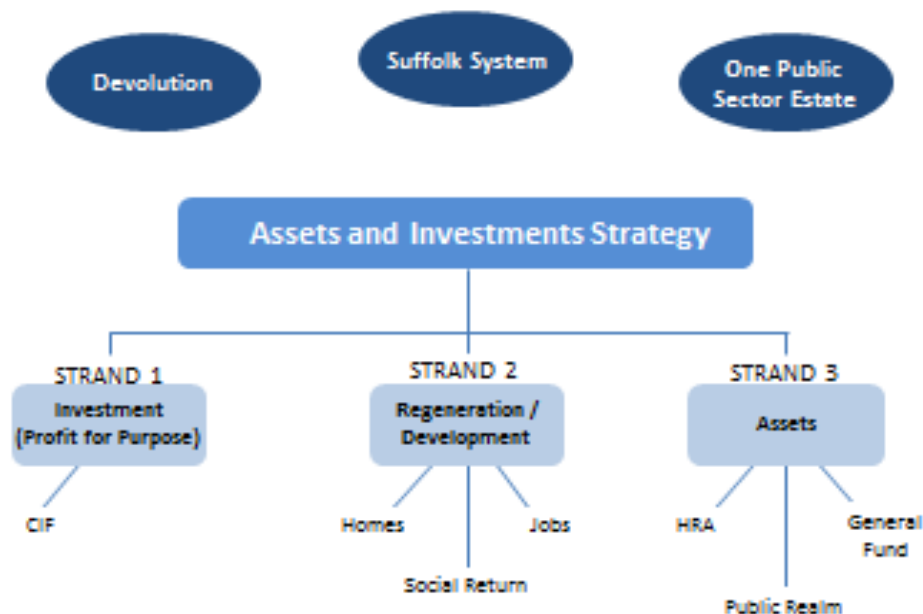
The Joint Strategic Plan describes how the Councils will deliver its Strategic Priorities, including: homes, business and jobs growth and support communities to do more for themselves through a range of key outcomes.

- The three strategic strands described below in section one, provide the framework through which the Council can achieve the objectives in the MTFs and JSP.

10.3 Section One – The three strands of the Assets and Investments Strategy

A clear approach to managing Assets and Investment ensures that the Council takes sensible investment decisions, makes best use of assets and manages those assets efficiently and effectively across its entire portfolio. It ensures the council maximises its impact towards its key strategic outcomes including; delivery of homes, jobs and business growth, its ambitions for communities to do more for themselves thereby reducing demand on public services. The approach aligns with the ambitions set out in the Refreshed Joint Strategic Plan 2016 – 2020 and the Medium Term Financial Strategy 2016/17 – 2019/20

The diagram below provides illustrates the work covered by each ‘Strand’;



10.4 Strand 1- Investment (Profit for Purpose)

10.5 This strand aims to set up structures and approaches to develop a financial return or ‘profit for purpose’. It looks to develop a range of commercial propositions which will create a financial return for re-investment in the councils’ services. Such structures might include wholly owned subsidiaries, Joint Ventures and Special Purpose Vehicles (SPV). The first of these, and the main subject of this report, is a proposal for a Capital Investment Fund Special Purpose Vehicle which will concentrate its efforts on direct commercial property investment by acquiring existing buildings on the open market for immediate revenue returns.

10.6 Strand 1 articulates the Councils ambition through the following wider objectives:

- Alignment with the refreshed Joint Strategic Plan 2016 – 2020 and Joint Medium Term Financial Strategy 2016/17 – 2019/20
- Delivers sustainable long term income flows from investing in commercial opportunities, maximising the use of resources
- Meets short and medium term objectives of generating income to support the revenue gap arising from the reduction in central government funding
- Creates a “Profit for Purpose”

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10.7 Strand 2 - Regeneration and Development

10.8 This strand is an acknowledgement that the Council has a key role to play in using its own assets and enabling/facilitating the use of private and other public sector assets to deliver housing and economic growth. The Council is currently both enabling and directly delivering these through existing land holdings and new acquisitions. Examples of this approach are the assembly of land at Hamilton Road Sudbury to deliver a regeneration scheme, the acquisition of a care home and middle school sites from Suffolk County Council for redevelopment of new homes (including affordable homes), the redevelopment of the existing Council Headquarters sites which will likely include homes, jobs most likely delivered through working with private sector partners.

10.9 Under this Strand, Members will be able to select the best place for its regeneration and development activity. The activity could be approved and delivered, as now, directly with the Council. Should a partnership opportunity or risk in a project make it more sensible to carry out that activity through the holding company structure being put in place under Strand 1 above, then Members can chose to take this route instead. Ultimately the structures being put in place allow flexibility in delivery whilst maintaining approvals with Members.

10.10 Strand 3 - Assets

10.11 This third strand focuses on the management, retention, alternative use, improvement and if appropriate, disposal, of the Councils existing assets. Work is underway across a number of projects to ensure that both the Housing Revenue Account and General Fund asset portfolio is managed effectively. Currently this work includes the review and grading of all general fund held assets, sheltered housing review and garage sites review. This strand is linked to an emerging estates regeneration strategy which is currently in development.

11. Section Two - The business case for a wholly owned incorporated structure for investment in commercial property

11.1 The purpose of the business case is to provide Members with a comprehensive appraisal of the objectives, risks, expected financial returns, structures and viability of the proposal to invest in commercial property. The case is borne out of a necessity to supplement, and ultimately replace, central Government financial support to the Council. The funding the Council currently receives from the Government in the form of Revenue Support Grant will reduce during the next four years and cease entirely by 2020.

11.2 The Council has developed and adopted a Medium Term Financial Strategy that has identified the need to develop a revised business model both to support the delivery of its Strategic Priority Outcomes and provide medium term financial sustainability.

11.3 In framing this strategy Members have prioritised property investment to generate income and in July 2016 appointed Jones Lang LaSalle (JLL) to explore how this might be achieved and whether there was a business case for such structures. This work has now been completed. The Business Case is attached to this report at Confidential Appendix 1.

12. Section Three - The recommended model for the wholly owned incorporated structure for investment in commercial property

12.1 The objective of the Capital Investment Fund Special Purpose Vehicle is to Invest in commercial property to generate long term revenue income streams to replace traditional funding and meet budget gaps – creating ‘profit for purpose’

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- 12.2 Local Authorities have general powers to acquire and dispose of land either for the councils functions or for the benefit or improvement or development of their areas, but when trading or exercising their power of general competence for a commercial purpose (profit) this must be done through a company.
- 12.3 Trowers and Hamlins LLP have been appointed to support the Council with legal advice regarding the most appropriate delivery and governance framework for an investment fund vehicle. They have undertaken an appraisal of three models which are suitable and the legal powers on which the Council will need to rely for each model.
- 12.4 In summary, the models considered were:

1.	An unincorporated model where the joint investment board remains within the Councils' constitutional structure. Not recommended
2.	An incorporated single special purpose vehicle. Not recommended
3.	An incorporated group structure. Recommended.

- 12.5 The recommended model involves both Councils setting up their own wholly-owned companies which then take a 50% equal shareholding in a jointly owned company limited by shares. Each of the Councils' own companies would be a holding/parent company which could also hold shares in other corporate vehicles that either Council may wish to establish later for example, regeneration companies, trading companies, limited liability partnerships, community interest companies, etc.
- 12.6 Although this structure seems at first sight to be more complex, in fact it affords maximum flexibility for the Councils and is highly resilient to potential political, corporate, constitutional or governance changes. This is because shares in companies can be transferred to other parties (such as another local authority, a combined authority, a private sector investor, employees), assets and potential liabilities are "hived off" within separate legal entities, companies can be wound up in the event of a desired exit and new subsidiary Companies can be established relatively quickly to fulfil different objectives. Companies can also be merged in the event that it is felt desirable to amalgamate/consolidate operations.
- 12.7 A full assessment of the advantages and disadvantages of this model can be found in paragraphs 8.6, 8.7 and 8.8 of the Trowers and Hamlins LLP options report attached as Appendix 2.

13. Section Four - The Implementation Plan for the wholly owned incorporated structure for investment in commercial property.

- 13.1 The implementation stage includes a range of actions, appointments and approvals that combined allow the initiation of the Capital Investment Fund SPV and trading.
- 13.2 The selection of Board Members will be based on a comprehensive skills and experience evaluation process which will seek to appoint Board Members based on their skills and experience. Independent Non-Executive Directors will be appointed through an externally advertised competitive process and will likely attract remuneration. The level of remuneration will be confirmed as part of the recruitment process but likely to be in a range of £5- £10,000 per appointment per annum.

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- 13.3 The following appointments will be necessary for each of the Holding Company Boards;
- Three Elected Members
 - A Member of the Executive Team (same individual for both Holding Companies)
- 13.4 The following appointments will be necessary for the Capital Investment Fund SPV Board;
- One Elected Member from each Council
 - A Member of the Executive Team
 - Three Independent Non-Executive Directors (Remunerated)
- 13.5 In addition, the following appointments and approvals will be undertaken;
- The appointment of legal consultancy to support and advise the Councils on company structure, including: articles of association; governance; voting rights; dispute resolution; constitution; financial model.
 - The development for approval of a Comprehensive Business Plan.
 - The Appointment of an Investment Fund Manager
 - Development of an Estate Management Model
 - Procurement of services – finance, administration, asset acquisition support.
- 13.6 The outcomes will be recommended to Full Council for approval in early spring 2017.

14. Appendices

	Title	Location
1.	The Business Case – Confidential	Attached
2.	Trowers and Hamblins LLP Capital Investment Options Paper	Attached
3.	Equality Impact Assessment	Attached

15. Background Documents

- 15.1 Link to Joint Strategic Plan:
<http://www.midsuffolk.gov.uk/assets/UploadsMSDC/Organisation/Corporate-Improvement/Joint-Strategic-Plan-Refresh-2016-2020FINAL.pdf>
- 15.2 Link to Medium Term Financial Plan & Councils Business Model:
<http://www.midsuffolk.gov.uk/assets/UploadsMSDC/Organisation/Democratic-Services/Council-and-Democracy/MSDC-Finance/MSDC-Medium-Term-Financial-Strategy/Joint-MTFS-MSDC-Feb-Full-Council.pdf>

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